BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	
Federal-State Joint Board on Universal Service	CC Docket No.96-45 DA 98-2410

COMMENTS BY CALIFORNIA ON JOINT BOARD SECOND RECOMMENDED DECISION

PETER ARTH, JR.
LIONEL B. WILSON
ELLEN S. LEVINE

505 Van Ness Ave.
San Francisco, CA 94102
Phone: (415) 703-2047
Fax: (415) 703-2262

Attorneys for the People of the State of California and the Public Utilities Commission of the State of California

December 23, 1998

TABLE OF CONTENTS

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	
Federal-State Joint Board on Universal Service	CC Docket No.96-45 DA 98-2410

COMMENTS BY CALIFORNIA ON JOINT BOARD SECOND RECOMMENDED DECISION

Pursuant to Public Notice DA 98-2410 in the above-referenced docket, the People of the State of California and the California Public Utilities Commission ("California" or "CPUC") hereby file these comments on the Second Recommended Decision of the Federal-State Joint Board on Universal Service, adopted November 23, 1998.

I. California Is Generally Supportive Of The Joint Board's Second Recommended Decision

In comments filed previously with the Federal Communications Commission ("FCC"), California has indicated its support for a federal universal service methodology for funding high cost areas that embodies seven principles: (1) the methodology uses forward-looking costs to determine high cost support; (2) federal high cost support is narrowly targeted to truly high cost areas throughout the nation; (3) the federal high cost support fund is modestly sized; (4) the methodology minimizes the burden on those that contribute to it, and reduces distortions in the marketplace caused by such methodology; (5) contributions to the federal high cost fund are based solely on assessing interstate

revenues; (6) recovery of federal charges for the high cost fund is only from interstate rates; and (7) the methodology for determining the level of high cost support is administratively simple to use and apply. All of these principles are consistent with the Telecommunications Act of 1996 ("1996 Act"). In addition, California has urged that the FCC methodology adopt a cost-based, instead of a revenue-based, benchmark for determining the level of federal support for high cost areas.

California is pleased that the Joint Board's Second Recommended Decision ("Second Rec. Dec.") advances a number of these fundamental principles and policies. Among other things, California supports the Joint Board's recommendation to implement a method for supporting universal service with a new mechanism that closely comports with the responsibilities which Congress assigned to the states and the FCC under the 1996 Act. Under this methodology, the Joint Board agreed to continue to rely on a forward-looking cost methodology that maintains the level of the federal high cost fund at or near the existing funding level. Second Rec. Dec. at ¶ 27. The Joint Board further agreed that the federal methodology should include a cost-based benchmark in lieu of a revenue-based benchmark. Second Rec. Dec. at ¶41. Both of these elements of the revised methodology parallel the methodology adopted by California for its intrastate universal service fund. In addition, the Joint Board recognized the need to limit the size of the federal fund to ensure "a balance between consumers who directly receive the benefits of universal service support and those consumers who must pay for the support through their rates." Second Rec. Dec. at ¶ 47. By maintaining the fund near the current

level, the Joint Board's recommendation properly minimizes any distortion to the telecommunications marketplace that federal subsidies might impose.

Notwithstanding the above, the Joint Board makes several recommendations that potentially undermine its goal of limiting the size of the federal fund. First, there appears to be an underlying assumption that a significant amount of universal service support exists in federal access charges which should be converted to explicit support and recovered through universal service fees. This untested assumption has the effect of increasing the federal fund beyond what was contemplated by the Joint Board in its decision.

Second, the Joint Board recommends the adoption of a "hold harmless" provision that would ensure that no non-rural carrier currently receiving federal universal service support ever receives a lesser amount. The Joint Board's recommendation is based on the assumption that without a hold harmless provision, non-rural carriers will experience significant or sudden decreases in support with an adverse impact on customer rates. Second Rec. Dec. at ¶ 51. Again, this underlying assumption may not be valid, and produces a fund that could otherwise be smaller where reductions of federal support to certain non-rural carriers would be appropriate.

The Joint Board has further defined "reasonable comparability" between urban and rural rates in a manner which departs from the FCC's Report and Order in Federal-State Joint Board on Universal Service, 12 FCC Rcd 8776 (1997) ("Universal Service Order"). In the Universal Service Order, the FCC adopted a funding mechanism designed to ensure that rates in high cost areas are reasonably comparable to rates in urban areas. The FCC,

however, made clear that reasonable comparability in Section 254(b)(3) of the 1996 Act did not mean that rates between rural and urban areas had to be identical. The FCC further made clear that rates between rural and urban areas should be reasonably comparable "within a State," and that "Section 254(b)(3) does not require the [FCC] to ensure that rural and urban rates in one State are no higher or lower than rural and urban rates in another State." Brief of FCC at 101 & 102-3, Texas Office of Public Utility Counsel v. FCC, No. 97-60421, et al., (5th Cir. 1997), pending. The Joint Board agrees that reasonable comparability does not require identical rural and urban rates. The Joint Board, however, recommends that rates between urban and rural areas should be reasonably comparable both within and among the states. Second Rec. Dec. at ¶ 18. The Joint Board has thus expanded the scope of Section 254(b)(3), with the potential effect of substantially increasing the size of the federal fund.

In addition to recommending measures that may increase federal universal service funding, the Joint Board recommends that carriers' contributions to the federal fund be based on both their interstate and intrastate revenues, assuming that such action is lawful.[1] This recommendation, however, is at odds with the FCC's Universal Service Order. There, the FCC declined to adopt a federal funding methodology for supporting high cost areas that would require carriers to assess their intrastate as well as interstate revenues in determining the amount of contribution by each carrier to the federal fund. Universal Service Order, 12 FCC Rcd 9776, ¶ 824. The FCC specifically stated that its approach

[1] This issue is currently pending in Texas Office of Public Utility Counsel v. FCC, No. 97-60421 (5thCir. 1997).

"promotes comity between the federal and state governments, and ... it continues the traditional informal partnership between the federal government and the states in supporting universal service." Id.

California discusses each of the Joint Board's recommendations below.

II. The FCC Should Proceed Cautiously In Determining The Extent To Which Interstate Access Charges Contain Any Implicit Universal Service Subsidies

California reiterates its support for the Joint Board's recommendation that high cost support remain near the current level. At the same time, however, California fears that the Joint Board's approach toward implicit interstate support may undermine this effort. Specifically, while the Joint Board does not make a recommendation regarding whether the FCC should eliminate implicit support in access rates, the Joint Board appears to assume that implicit universal service support is contained in such rates. Second Rec. Dec. at ¶ 23. Moreover, the Joint Board appears to assume that the level of implicit support in access rates is large. However, by not defining implicit support, it is difficult to know the nature or the magnitude of the perceived problem. California continues to believe that not all anomalies or inefficiencies in interstate access design can or should be labeled "implicit support," converted to universal service support, and recovered as a universal service fee. Since this process will undoubtedly lead to a shift between those currently paying access fees and those paying universal service fees, California believes that this issue needs careful consideration. California thus urges the FCC to proceed cautiously within the context of the access reform proceeding in defining

access rate structure anomalies as a universal service issue which impacts the federal universal service fund.

III. Consistent With The Intent To Limit The Overall Size Of The Federal Universal Service Fund, The FCC Should Not Adopt A Rigid Hold Harmless Provision For Non-Rural Carriers

California is also concerned with the Joint's Board's recommendation to adopt a hold harmless provision, especially with respect to non-rural companies, in funding universal service. Second Rec. Dec. at ¶ 53. Although a hold harmless provision is not required by the 1996 Act, the Joint Board argues that such a provision is necessary to prevent rate shock. At the same time, however, such a provision guarantees that high cost support can only grow and never shrink. California believes that a rigid hold harmless provision prevents any reduction in support, no matter how insignificant, even when it would not result in a drastic change in rates. In addition, with the possible exception of Puerto Rico Telephone Company, California is not convinced that rate shock will occur for non-rural companies, as these companies do not currently receive a large amount of federal universal service support per subscriber. California is thus concerned that a rigid hold harmless provision without at least some potential for reducing support for some companies is antithetical to the goal of maintaining federal funding near the current level.

IV. The FCC Should Implement The Reasonable Comparability Standard In A Manner Which Does Not Increase The Size Of The Federal Fund

California has two concerns about the Joint Board's decision to broaden the FCC's previously adopted meaning of "reasonable rate comparability" to include urban and rural

rates *among* states as well as within a state. The first concern is that such an expansion may have the effect of increasing the overall size of the federal fund, and hence, undermine the FCC's policy of not unduly burdening ratepayers. The second concern is that the expanded standard could compel California's urban ratepayers to subsidize rural customers, such as farmers in Montana. These concerns, however, could be mitigated if the FCC carefully ensures that no state contributes more to the federal fund than it currently does under existing procedures. Only by so doing can the FCC properly balance the two competing goals of "(1) supporting high cost areas so that consumer there have affordable and reasonably comparable rates; and (2) maintaining a support system that does not, by its sheer size, over-burden consumers across the nation." Second Rec. Dec. at ¶ 3

V. The Federal Methodology Should Not Assess Carriers' Total Revenues For Calculating The Federal Contribution

As the Joint Board correctly states, in its Universal Service Order, the FCC expressly determined that the assessment of contributions for the interstate portion of the high cost fund shall be based solely on the revenues from interstate services purchased from end-users. Second Rec. Dec. at ¶ 62. Among other things, the FCC declined to assess intrastate revenues as well "because the states are currently reforming their own universal service programs, and it would have been premature to assess contributions on intrastate revenues before appropriate forward-looking mechanisms and revenue benchmarks are developed." Id.

In its decision, the Joint Board tentatively recommends that if the Fifth Circuit in Texas Office of Public Utility Counsel v. FCC determines that the FCC may lawfully assess intrastate revenue for calculating the interstate portion of the federal universal service charge, then the FCC should reconsider its decision not to assess intrastate revenues. Id. at ¶ 63. The Joint Board, however, states that if the FCC finds that it may assess total revenues, and does so, then "the [FCC] should find that states may do the same for their state universal service mechanisms." Id. The Joint Board alternatively asks the FCC to consider assessing carriers on a flat, per-line basis so as to avoid the alleged difficulties of assessing only interstate revenues. Id.

As set forth in briefs filed in the Fifth Circuit in Texas Office of Public Utility Counsel v. FCC, a substantial question is raised whether, consistent with Section 152(b) of the Communications Act of 1934, the FCC may lawfully assess the revenues of intrastate services of a carrier in calculating a federal charge paid by such carrier to support universal service. Not only does Section 152(b) fence off from FCC reach or regulation matters for or in connection with intrastate service, Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 370 (1986), but the 1996 Act respects this jurisdictional division. As provided in Section 254(d), "every telecommunications carrier that provides *interstate* telecommunications services shall contribute" to federal universal service mechanisms. (emphasis added). In parallel, Section 254(f) provides that "[e]very telecommunications that provides *intrastate* telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State" to state universal service mechanisms. (emphasis added). By these two sections, Congress

expressly distinguished between the types of services – interstate and intrastate – offered by telecommunications carriers for the purpose of apportioning jurisdiction to the FCC and the states, respectively, to fund federal and state universal service programs.[2] For federal programs, funding must come from the carrier's interstate services; for state programs, funding must come from the carrier's intrastate services. It follows then that in calculating the level of charge that a carrier must contribute to each universal service program, the FCC must base the federal charge on a carrier's interstate revenues from interstate services.[3] A state in turn must base any state charge on a carrier's intrastate revenues from intrastate services.[4]

These, and other legal arguments, have been made to the Fifth Circuit, and the Joint Board has prudently recommended that the FCC await the decision of that court before it considers reversing its position in the Universal Service Order. However, assuming that the court upholds the FCC's authority to assess intrastate revenues for calculating the federal universal service charge, the FCC should decline to do so for several reasons.

---

[2] Congress made a similar distinction in Section 254(h)(1)(B) between interstate and intrastate services for the purpose of dividing jurisdictional responsibility for determining the amount of discount applicable to schools and libraries. (Section 254(h)(1)(B) provides that the "discount shall be an amount that the [FCC], with respect to interstate services, and the States, with respect to intrastate services, determine is appropriate and necessary.")

[3] Section 254(k) further divides federal and state jurisdiction over cost allocation by providing that the FCC "with respect to *interstate* services, and the States, with respect to *intrastate* services, shall establish any necessary cost allocation rules [and] accounting safeguards ... to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."(emphasis added).

[4] To be sure, the federal program in effect prior to the Universal Service Order relied solely on interstate revenues for its funding.

First, as the Joint Board itself recognizes, the state must be given the authority to assess interstate revenues in calculating a state charge for state universal service programs if the FCC assesses intrastate revenues. Second Rec. Dec. at ¶ 63. However, a significant question arises whether states could lawfully assess interstate revenues for calculating a state charge for its universal service program. In AT&T Communications of the Mountain States, Inc. v. Public Serv. Comm'n, 625 F.Supp. 1204 (D. Wyo. 1985), the FCC objected to the state commission's assertion of authority to calculate a state-imposed charge based on AT&T's interstate and intrastate revenues. The court agreed that the state lacked authority to impose charges on that basis. Based on this legal uncertainty, Commissioner Gloria Tristani correctly questioned whether it would be desirable for the FCC to assess both interstate and intrastate revenues, assuming it had such authority, if states could not do the same.

Moreover, as stated by Cincinnati Bell in its brief to the Fifth Circuit in Texas Office of Public Utility Counsel v. FCC, as a practical matter, an FCC decision

> "to assess intrastate funding will ...preclud[e] states from developing their own adequate funding mechanisms. Having used both interstate and intrastate revenues as the funding basis for federal programs, the FCC did not leave any source of funding for states that would not arguably burden the federal support mechanism [under Section 254(f)]."

Reply Brief of Cincinnati Bell at 16.

Commissioner Harold Furchtgott-Roth also points out, in addition to finding a lack of federal authority to assess intrastate revenues, that a recovery mechanism that assesses intrastate revenues at the federal level but permits recovery of such revenues solely

through interstate rates unduly discriminates against carriers in violation of Section 254. Specifically, carriers which derive a significant amount of their revenues from intrastate activities would be forced to pay more in federal universal service charges than that paid by purely intrastate carriers. Carriers with significant intrastate revenues would also be competitively disadvantaged against many interstate carriers because the former would be required to recover the intrastate portion of their federal contribution solely from interstate rates.[5] To be sure, as both Commissioner Furchtgott-Roth and State Commissioner Laska Shoenfelder correctly conclude, Section 152(b) of the Communications Act bars the FCC from requiring carriers to seek recovery of their intrastate revenue contribution in intrastate rates.[6] The FCC should therefore decline to assess intrastate revenues for calculating the federal universal service charge in order to avoid the competitive inequities that a mismatch in revenue assessment and cost recovery might otherwise cause.[7]

---

[5] For example, suppose a local exchange carrier derives 90 percent of is revenue from intrastate services and only 10 percent from interstate services. Suppose further that such carrier competes with an interexchange carrier that derives 90 percent of its revenue from interstate services and 10 percent from intrastate services. The local exchange carrier would need to recover 100 percent of its contribution from 10 percent of its customers, while the interexchange carrier could spread its cost over 90 percent of its customers.

[6] California has consistently stated in comments before the FCC and in briefs before the Fifth Circuit in Texas Office of Public Utility Counsel v. FCC that the FCC lacks authority to require carriers to seek recovery of federal universal service charges in intrastate rates. California reiterates that position here.

[7] It bears noting that the inclusion of intrastate revenues in the contribution base for federal universal service does not alter the amount of funding available; such inclusion only affects the amount of contribution that each carrier must make.

VI. CONCLUSION

While California is generally supportive of the Joint Board's Second Recommended Decision, California respectfully urges that the FCC carefully consider the effect of particular recommendations on the overall size of the federal fund. In addition, California strongly urges the FCC not to assess intrastate revenues for calculating a federal universal service charge.

Respectfully submitted,

PETER ARTH, JR.
LIONEL B. WILSON
ELLEN S. LEVINE

/s/ ELLEN S. LEVINE

ELLEN S. LEVINE

505 Van Ness Ave.
San Francisco, CA 94102
Phone: (415) 703-2047
Fax: (415) 703-2262

Attorneys for the People of the
State of California and the
Public Utilities Commission of the
State of California

December 23, 1998

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing document to be served upon all known parties of record by mailing, by first-class mail, postage prepaid, a copy thereof properly addressed to each party.

Dated at San Francisco, California, this 23rd day of December, 1998.

/s/ BERLINA GEE

Berlina Gee